

October 8, 2004

HAND DELIVER

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, Massachusetts 02110

Re: The Berkshire Gas Company - D.T.E. 04-47

Dear Secretary Cottrell:

In a Memorandum dated October 1, 2004, the Hearing Officer granted the Attorney General's request for the opportunity to issue additional discovery on and brief issues related to an audit performed with respect to the calculation of savings generated pursuant to the 2002 Agreement and the allocation of such savings to Berkshire and the other LDCs.¹ Consistent with the Memorandum, on October 4, 2004 the Attorney General issued his third set of information requests in this proceeding. The Company filed its responses to the Attorney General's third set of information requests on October 6, 2004.

The 2004 Audit Report was the result of a wholly voluntary undertaking by Berkshire and the LDCs to assess "procedures and controls" associated with the calculation and reporting of savings achieved in the alliance pursuant to the 2002 Agreements and also to review compliance with allocation procedures. As noted previously, the 2004 Audit Report concluded that procedures and controls relating to the calculation of savings were "reasonable and functioning as intended." The allocation process was also found to be "generally implemented as intended," with the audit team suggesting some limited enhancements. Co. Reply Br., p. 11; Exh. DTE-1-25 (Supp.) The Company is, in fact, implementing these suggested enhancements. Exh. AG-3-5. This reply letter will address several of the erroneous statements made in the Attorney General's reply brief regarding the 2004 Audit Report and the related procedures.²

¹ Capitalized terms not defined herein shall have the same meaning as in the Company's Initial Brief dated September 24, 2004 or its Reply Brief dated October 1, 2004.

² The Company notes that the Attorney General's reply brief contained other erroneous statements on the record evidence and applicable precedent. These issues are not addressed herein consistent with the scope limitations established by the Hearing Officer. Any failure to address any statement of the Attorney General should not be deemed to constitute a concession or waiver.

The Attorney General has repeatedly argued that somehow the 2004 Audit Report is of "limited value." AG Reply Br., p. 1. The principal arguments advanced by the Attorney General are that: (i) the audit team was somehow not appropriate; (ii) that the audit was flawed because each and every transaction was not "audited;" and (iii) the suggestion that the fact that the audit results were positive and that the audit did not extend beyond the typical scope of audit practice for the alliance must somehow be read against the Company. These arguments are readily dismissed.

First, the Company assigned an experienced team of experts to the audit. This same team had completed a prior analysis of the alliance. See Berkshire Gas, D.T.E. 02-19, pp. 2, 4-5. The lead auditor was Thomas Deering. Mr. Deering's experience, expertise and diligent work processes are evident from his curriculum vitae and the comprehensive workpapers presented to the Department. Exh. AG-3-1, Att. A, p. B-1 (The audit team devoted nearly 450 hours to the effort.); Exh. AG-3-2. This same expert team was expressly recognized by the Department. Berkshire Gas, D.T.E. 02-19, p. 18 ("The Department notes that the record shows that the audit of the 2001 [Agreements] was performed by qualified personnel of the members of the [A]lliance whose training and expertise were in internal auditing."). The Department also went on to reject the Attorney General's previous suggestion that an "external" audit was necessary. Id. Internal auditors are subject to professional standards and, again, the best evidence of diligence of the audit is the detailed workpapers maintained by the audit team. See Exh. AG-3-1; cf. Berkshire Gas, D.T.E. 02-19, p. 4, n. 7. Accordingly, the Department should again find (to the extent any such finding is necessary in connection with the Company's petition in this proceeding), (i) that the 2004 Audit Report was prepared by an appropriate team of experts, experienced in and familiar with the natural gas industry generally and, more specifically, the alliance structure reflected in the Agreements, and (ii) that the audit team completed a comprehensive, diligent and appropriate audit analysis.

The Attorney General's next line of criticism is that somehow the 2004 Audit Report is "flawed" because the audit team did not review all alliance transactions. Again, this agreement demonstrates the Attorney General's lack of understanding of the most basic audit practices. Similar to the audit of the 2001 Agreements, the 2004 Audit Report was based upon a comprehensive analysis of targeted months. The audit of the 2001 Agreements reflected a detailed audit of a single month, September 2001, because, as the Company explained, "this election enabled the auditors to examine and review activities and transactions at a greater degree or depth." Id. at 5. The audit team selected three separate months for the recent audit. Exh. AG-3-4. The three months covered an appropriate range of conditions: (i) a contract year close-out month; (ii) a storage "fill" month; and (iii) a storage "withdrawal" month. Id. The Company again explained that the goal of an audit is never to review all underlying transactions (Id.), but rather to do an analysis that is sufficient so as to be able to reach conclusions on your audit objectives. Here, the audit objective was an analysis of procedures and controls. Importantly the audit team indicated that if further analysis had been necessary

or appropriate, such efforts would have been pursued. Id. In sum, the Department should again find that the audit team's analytical approach was appropriate and reasonable.³

Finally, the Attorney General suggests that the 2004 Audit Report is flawed because it does not address concerns that were never within its proper scope. The Attorney General has argued that the audit team should have monitored BP Energy's derivative activity so as to reduce risk to the Company from these transactions. AG Reply Br., p. 2. As a practical matter it is not possible to reduce Berkshire's risk in this area. The Agreements are specifically structured so that Berkshire has no exposure from BP Energy's derivative transactions. Co. Reply Br., p. 5. In any event, this argument in no way takes away from the firm conclusions drawn by the audit team that procedures and controls are appropriate and that savings and allocations of savings were calculated as intended. The Attorney General simply cannot refute the fundamental conclusion that procedures and controls "were reasonable and functioning as intended" and that the allocation process was implemented as intended.

In sum, the Attorney General's argument with respect to the 2004 Audit Report are off the mark. The decision to pursue the audit demonstrates Berkshire's strong commitment to diligence and regulatory compliance with respect to the alliance. This entirely voluntary effort should be recognized as the positive step that it was. Once the decision to conduct an audit was made, the audit was pursued comprehensively, diligently and appropriately. The 2004 Audit Report was filed with the Department and made available to the Attorney General within hours of its completion. There is nothing in the 2004 Audit Report that suggests, in any way, that the Department should not approve the alliance structure for the third time in this proceeding.

Accordingly, for all the reasons stated herein, in the Company's Initial Brief and Reply Brief and in the Company's testimony, the Department should take such actions as may be necessary and appropriate and issue an order approving the Agreements, affirming the application of the Department's established margin sharing principles to the Company's alliance activities and affirming that the Company's treatment of certain, limited legal costs associated with the 2002 Agreement had been appropriately reflected in the Company's CGAC. Finally, the Company notes that the Department's consideration of its petition in this proceeding by October 31, 2004 may likely be necessary to ensure that the Company's customers continue to benefit from the alliance structure. Exh. AG-1-3, Att. A. Therefore, the Company respectfully urges the Department to complete its review and issue its order by not later than October 31, 2004.

³ The Attorney General repeatedly refers to the concept of a "statistical sample" in the contest of an audit. AG Reply Br., p. 2, n. 4. The Attorney General has offered no basis to suggest that this concept is in any way appropriately considered in the audit process.

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Thank you for your consideration.

Very truly yours,

BROWN RUDNICK BERLACK ISRAELS LLP

By: _____
James M. Avery

JMA/gm/cdw

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